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LIABILITY OF STOCKHOLDERS.

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Questions of personal liability arising from the subscription to and the ownership of stock in corporations are of great practical importance and are constantly increasing in frequency.

To simplify the discussion of these questions all business enterprises which have their property divided into transferable shares will be considered, as far as practicable, together, and that whether they are those to which charters are specially granted and which are, strictly speaking, corporations; or those organized under some general enabling act permitting such association, and are joint-stock companies, or are those lastly, which were intended to be either corporations or joint-stock companies, but which by reason of their imperfect or defective organization have fallen short of being either and yet have acquired an existence *de facto*, and which for certain purposes the law will treat as corporations or joint-stock companies. At common law there was no personal liability growing out of the ownership of stock in a corporation. Such an idea is inconsistent with one of the fundamental characteristics of a corporation.

Of late there has been a growing tendency in public sentiment to impose such personal liability under every and all circumstances.

Many of the States of our Union have placed in their constitutions, provisions imposing such personal liability. In those States, such enactments have as it were been written into the charter of every corporation thereafter created and become as much a part of its charter as if special provisions to that effect were inserted in it. But even in States where no such constitutional provisions exist, if a charter contained a special provision imposing personal liability, even though the corporation thereby created be in the strictest and fullest sense a corporation, if the incorporators accept such charter and carry on business under it, they and all subsequent stockholders take their stock subject to such liability.

In other States where no such constitutional provision exists, statutes have been enacted imposing a general personal liability

upon all stockholders in corporations and the constitutionality of such an enactment as effecting subsequently created corporations, cannot be questioned.

A charter in which there is no provision imposing personal liability, cannot be changed in this respect by the subsequent enactment of a general statute, unless the legislature in granting such charter, had in some manner reserved to itself the power to alter, amend or repeal the same. Such attempt would be illegal and void as impairing the obligations of a contract.

The various enabling acts of the different States under which joint-stock companies may be organized, confer upon such organizations most of the special privileges granted to corporations, and not infrequently contain a provision expressly declaring that such companies shall not be corporations. The object of inserting such a provision being for the very purpose of imposing more or less of personal liability upon the stockholders in such concerns, and such personal liability being as we have before said, inconsistent with the idea of ownership of stock in a corporation. The provisions usually contained in these enabling acts, which are in the nature of conditions precedent to the legal organization of such joint-stock companies, and which impose a special liability on the person failing to comply with them, we shall not attempt to consider except so far as the question is necessarily presented by the ownership of stock in a *de facto* joint-stock association. Treating, then, all these concerns, so far as practicable, as corporations, it may be said generally : That the subscriber to the capital stock of a corporation is bound to pay the par value of such stock, and when that has once been paid all liability forever ceases ; and this exemption is carried with the stock to the subsequent owner or transferee of the same ; this exemption need not be declared in terms in the charter, for it is, as we have said, inherent in the very idea of a corporation, and necessarily exists, unless the charter or enabling act in terms expressly declares to the contrary.

This does not necessarily imply that the subscriber to the capital stock of any of these corporations agrees to pay for the same in cash ; he may pay for them in labor, material, letters patent, real estate, book accounts, good-will, and even in newspaper advertising. The law permits him to pay for them in money or in "money's worth." This indulgence, however, must be exercised in good faith and cannot be taken advantage of, as a cloak, under the guise of which subscriptions can be paid in worthless property.

In absence of fraud the courts will treat as payment that which the parties have agreed shall be payment. This exemption from payment in cash, does not, of course, apply to joint-stock companies organized under enabling acts which require that a certain per cent of the stock subscribed shall, before the company becomes legally organized, be paid for in cash. Such provisions must be strictly complied with and in such cases "money's worth" up to that per cent, cannot take the place of money.

The capital stock of a corporation and the unpaid subscriptions to it are said to constitute a trust fund for the benefit of the creditors of the corporation ; and the officers of a corporation cannot impair this trust fund by accepting simulated or fictitious payments for such subscriptions.

When the corporation accepts as payment for its capital stock property, not only must the transaction be free from fraud but such property must be of a character capable of being used by the corporation in its legitimate business and available as such, or such transaction will be *ultra vires*. Simulated subscriptions for stock by persons who have neither the ability nor purpose to pay for them, are not only a fraud upon this trust fund, but upon the law itself and no arrangement between the agents or promoters of the corporation with a subscriber whereby such subscription is merely colorable, will prevent the courts on the application of an innocent stockholder or a creditor, from disregarding such arrangement and compelling the subscriber to pay in full for his stock ; and this rule holds good even in the absence of any actual subscription to the stock of the corporation, for the law implies from the reception of the stock itself which has not been paid for in full, a promise to pay for the same where it is necessary to make good such "trust fund."

Different courts have arrived at different conclusions respecting the law that should govern in such cases, some courts holding that in the absence of fraud the parties to such contract are at liberty to make such agreement as they see fit, and that the courts will enforce them ; others that it is illegal for the parties to enter into any contract whereby capital stock can be issued for anything less than its par value ; that as against creditors and other stockholders the stock so issued is in law a fraud upon the trust fund, to which such stockholders and creditors have a right to look for their security.

These two views are illustrated, one by the opinion of the Court of Appeals of the State of New York, and the other by the Supreme Court of the United States.

The New York Court holds that the liability of a shareholder to pay for stock does not arise out of his relation to the corporation, but depends upon his contract, expressed or implied or upon some statute ; and in absence of either of these grounds of liability, holds that even where shares of stock have been issued to a person as a gratuity, that by accepting them, such shareholder has committed no wrong upon the creditors and has not made himself liable to pay the par value of the shares.

The effect of the rule established by the Supreme Court of the United States is that subscriptions to the capital stock of a corporation which is being organized, must be paid in full at par, and that no contract entered into between the subscriber to the corporation or its agent can relieve the subscriber from that obligation, upon the suit of a subsequent creditor who relies upon such capital stock as a trust fund to which he looks for the payment of his debt.

In such cases the court holds that a conclusive presumption of law is raised that any agreement short of actual payment in full, is a fraud upon such trust fund and such creditors ; and that the acceptance of stock even in the absence of a contract of subscription creates, as we have before said, an implied promise to pay for the same in full. This rule as laid down by the Supreme Court of the United States, however, is limited to subscriptions to the original stock of a corporation and has no application to a "going concern." Subscriptions therefore to an increase of capital stock are placed upon a different footing. When a corporation therefore, that is a "going concern," finds its original capital impaired for any reason, it may for the purpose of recuperating itself provide new conditions for the successful prosecution of its business, increase its capital, issue new stock and sell it upon the best terms it can obtain, without thereby imposing upon the subscriber to or purchaser of such stock any duty to make good the difference between the price paid or agreed to be paid and the par thereof.

The reason of this rule is very easy of apprehension. So far as existing creditors are concerned they have no ground to complain ; the trust fund to which they look for payment is increased, and the corporation must stand by the bargain that it has made ; but why there should be any difference so far as subsequent creditors are concerned between a "going concern" which has thus increased its capital stock and a corporation that is just being organized it is hard upon principle to say. The reason for the rule, if it be a rule, probably grows out of the necessity of the case. No "going concern" whose original capital stock has

become depreciated in value could induce people to subscribe for its increase of capital stock at any price higher than that depreciated value, and it is clearly for the benefit of all concerned that the corporation should have an opportunity of recuperating itself, and provide new conditions for the successful prosecution of its business.

The law recognizing that necessity would seem to say that where such additional capital stock was issued at a price below par, if upon a full examination of the transaction it was found that such stock was issued at that price, in good faith, that the subscriber of it or receiver of it could not be held for any deficiency, even upon suit of a creditor to make good the difference between the price which he agreed to pay, and in fact did pay, for it and the par value thereof. And this rule would be true even where stock has been issued gratuitously, if such gratuitous issue has added to the value of certain bonds upon which the corporation was seeking to borrow money and which could not have been borrowed except such gratuitous stock has been given as a bonus for the purpose of obtaining such loan.

As against creditors there is no difference between unpaid subscriptions on stock and any other assets, which may form a part of the effects of a corporation. Not only are unpaid subscriptions assets, but they have frequently been treated by courts of equity as if impressed with a trust *sub modo*; upon the view, that the corporation being insolvent, the very fact that creditors exist imposes upon those uncollected assets, something in the nature of a trust, requiring them to be held and accounted for as trust funds.

Statutes of limitation, therefore, do not commence to run in respect to them until the retention of the money has become adverse by the refusal to pay. There is no obligation resting on the stockholder to pay his subscription at all until some authorized demand on behalf of creditors or the corporation is made for payment. The stockholder owes the creditor nothing, and he owes the corporation nothing—assuming a contract to exist between him and it—save only such unpaid portion of his subscription as may be necessary to satisfy the claims of creditors. Upon the insolvency of the corporation, he must pay upon his unpaid stock only what is sufficient, with the other assets of the company, to pay its debts. He is under no obligation to pay any more, nor to pay that, until the amount necessary for him to pay is at least approximately ascertained. Until this is done his obligation to pay does not become complete. Where the company

refuses or neglects to make the call a court of equity will do that which it is the duty of the corporation to do.

Constituting, as unpaid subscriptions do, a fund for the payment of corporate debts, when a creditor has exhausted his legal remedies against the corporation, and the corporation fails to make any assessment upon such subscribers, he may, by a bill in equity, or other appropriate means, subject such subscriptions to the satisfaction of his judgment, and the stockholders cannot then object that no call has been made; they cannot protect themselves from paying what they owe by setting up the default of their own agents.

In the words of the late Mr. Justice Bradley such defense "Is but a spider's web, which the first breath of the law blows away."

Capital stock is sometimes distributed to a shareholder as a dividend. Assuming it to have been legally and properly done, such stock carries with it no personal liability. These new shares in contemplation of law are full paid by the transfer from the surplus in the treasury of the company to the account representing capital stock. After the stock dividend the company has just as much property as it had before.

Capital stock is sometimes increased irregularly and improperly. In such cases the existence of personal liability turns upon the question whether the stock so issued is void or voidable. Stock issued in excess of the limit of the charter is absolutely void as *ultra vires*. Its reception by a stockholder imposes no implied agreement to pay anything for it. The holder is not estopped in a suit against him by a creditor seeking to compel him to pay for such stock, from setting up such irregularity, from showing that the stock is absolutely void. But in cases where the irregularity consists in any defect in the manner in which the increase was made, such as not filing the required certificate of increase, or some defect in the call for or manner of conducting the meeting when the increase was voted — things which the State alone would have the right to proceed against the corporation for not doing; then a stockholder who had received such increased stock, no matter upon what terms, as between himself and the corporation, will be held liable on his implied liability to pay for the same in full or the suit of a creditor of the corporation who has trusted it on the faith of the stock so issued. After the rights of creditors have intervened it is then too late to disclaim ownership of the stock so as to escape liability.

When the capital stock in a corporation is reduced either in the number of its shares or the par value of the same such reduc-

tion does not relieve an original subscriber or existing stockholder, because such reduction can in no wise affect antecedent creditors who have trusted the corporation upon the faith of its capital before such reduction; but subsequent creditors are properly affected by the implied notice of such reduction.

The transfer of shares upon which a certain amount is still due, in good faith, to a solvent party, when such transfer is perfected by a change of ownership upon the books of the corporation, will relieve the original subscriber and transfer the obligation to the purchaser, but such transfer must be made in absolute good faith to a person who at the time is pecuniarily responsible and liable to a suit. The attempted transfer to a person of no pecuniary ability or to a minor or to anybody incapable of being sued does not relieve the original subscriber.

Where the charter of a corporation or the general enabling acts permit a corporation to acquire by purchase its own stock, such a purchase by it from subscribers of stock not full paid will not relieve the subscriber or stockholder from his liability to pay for the balance due where the corporation is insolvent or becomes insolvent immediately after such purchase.

Directors of a corporation cannot release a subscriber from his obligation to take the number of shares of stock subscribed for by him though all of the stockholders unite and execute valid releases. The release from such a subscription, however, may be set aside by creditors after the corporation has become insolvent. A subscriber may be released from his obligation upon a fair, just compromise, a portion of the subscription being paid as a consideration for the release of the balance.

The utmost good faith, however, must be observed in order to effectuate such a compromise and can be inquired into, and is subject to the supervision of the court. The failure of the corporation to obtain subscriptions to an amount required by the charter, or to the extent of the full capital stock, if the charter requires that, would be a defense which a stockholder could avail himself of in a suit even by a creditor, as such complete subscription, is a condition precedent to any legal organization of a corporation. A condition in the subscription paper itself that the subscriptions should not be binding until a certain amount was subscribed would have the same effect, though a stockholder, of course, might waive the performance of such conditions.

At a suit by the corporation itself, a subscriber to the capital stock would be at liberty to off-set any claim which he might have against the corporation, but at the suit of a creditor who was

seeking to enforce the personal liability the courts do not permit the defense of set-off to be interposed.

The subscriber must pay his debts in full and if in so doing he pays more than his just proportion, the right of contribution is open to him to collect from the other stockholders who have not paid for their stock in full.

Many of the general statutes and enabling acts contain provisions imposing more or less of personal liability upon stockholders for the benefit of creditors, requiring them to pay in addition to the par value of their stock a further and other sum to the "amount of their stock," or "to double the amount of their stock," or some other required amount, also making them personally liable when certain certificates required by law have not been filed. These provisions are generally penal in their character and are usually confined to the limits of the jurisdiction enacting them. They have given rise to a great deal of litigation, but their discussion opens up too wide a field to be considered at the present time in an article of this character.